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INTERNAL AUDIT DIVISION
OFFICE OF INTERNAL OVERSIGHT SERVICES

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26 August 2002

To: Mr. Benon Sevan, Executive Director
Office of the Iraq Programme

Mr. Jean-Pierre Halbwachs, ASG and Controller,
Department of Management

From: Esther Stern, Director
Internal Audit Division, OIOS

A handwritten signature in black ink, appearing to be 'ES', located next to the 'From' field.

Subject: **OIOS Audit Number AF2001/35/1: Audit of budget practices for the SCR
986 (1995) 2.2 per cent account**

1. I am pleased to present herewith the final report on the subject audit, which was conducted at United Nations Headquarters in December 2001 and January 2002. Based on your response, we are pleased to inform you that we have closed recommendation 007 in OIOS' database. Recommendations 002, 004, 005, 006, 008 and 010, which are in the process of being implemented, will be closed upon receipt of documentation as indicated in the report text.

2. OIOS is reiterating recommendations 001, 003 and 006 for further consideration. As no response was received concerning recommendation 009, please advise whether this recommendation has been accepted.

3. IAD is assessing the overall quality of its audit process and kindly requests that you consult with your managers who dealt directly with the auditors and complete the attached client survey form.

4. I take this opportunity to thank you and your staff for the assistance and cooperation provided to the auditors on this assignment.

Copy to:
Mr. J. Connor
UN Board of Auditors
Planning and Compliance Officer, OIOS
Mr. D. Knutsen



United Nations
OFFICE OF INTERNAL OVERSIGHT SERVICES
Internal Audit Division

Audit Report

- **Audit subject:** Audit of budget practices for the SCR 986 (1995) 2.2 per cent account
- **Audit No. and location:** AF2001/35/1
- **Report date:** 26 August 2002
- **Auditor:** Dagfinn Knutsen, Auditor-in-Charge
Andrea Charles-Browne, Auditor
Monica Tiongson-Eppert, Assisting Auditor
Anna Halasan, Auditing Assistant

Audit of budget practices for the SCR 986 (1995) 2.2 per cent account

AF2001/32/2

Executive Summary

From December 2001 to January 2002, OIOS conducted an audit of the 2.2 per cent account budget practices and procedures for UN agencies implementing programmes in Iraq under Security Council Resolution 986 (1995). The major objectives of the audit were to: (i) assess the adequacy of the procedures to prepare, review and approve the 2.2 per cent budget; (ii) evaluate the appropriateness of the budget submissions by the UN agencies; and (iii) determine if appropriate procedures had been established to monitor the implementation of the budget. OIOS found that OIP and the Controller had been vigilant in reviewing budget requests from UN agencies and had effectively controlled cost escalations. However, there was a need to strengthen monitoring of budgets and more effectively analyze expenditures.

Results in brief:

Policies and Procedures

- ❑ The roles of OIP, UNOHCI and Controllers' Office in the budget review process were not clearly defined or documented. Furthermore, ad-hoc budget procedures had been adopted by UNOHCI to review the UN agencies' budgets resulting in the budget process not being effectively organized and carried out. As a result, the Controller's office routinely made significant adjustments to the budgets. In Phase 10, for example, the Controller reduced the 2.2 per cent budgets submitted by the UN agencies by approximately \$10 million or 14 per cent.

Budget Monitoring and Control

- ❑ In view of the significant environmental and operational risks of UN agencies' operations in Iraq, inadequate provision was made in UN agencies' budgets for internal auditing. Hence, an important internal control procedure has not been fully established.
- ❑ OIP and the Controller placed heavy reliance on the audited financial statements to monitor budget activities of the UN agencies in Iraq. However, the financial statements often did not provide adequate information on the use of funds hence it was not possible to verify expenditures. Furthermore, some UN agencies had not submitted audited financial statements to the Accounts Division as required by the MOU with OIP.
- ❑ OIP did not ascertain the authenticity of certification of monthly financial reports as evidenced by the absence of a list of certifying officers and specimen signatures. In fact, some agencies failed to certify the reports. Furthermore, the standard financial reporting format required by OIP was not being used by all agencies resulting in less than adequate disclosure.

- ❑ As at June 2001, the total interest paid to Accounts Division by agencies on funds advanced to them was \$573,818, however the interest amounts paid were not supported by documentation and therefore could not be verified. Moreover, no verification check was made by OIP or Accounts Division to determine if interest amounts paid by the UN agencies were accurate.

Budget Expenditure Analysis

- ❑ The budgets for the UN agencies operating in Iraq is approved based on expenses in various categories, however, no procedures had been established to require approval from the Controller to redeploy funds between these expense categories. Furthermore, OIP did not monitor the recording of expenditures against the line item allotment or check budget variances on a regular basis.
- ❑ Five UN agencies, including the UN Coordinator for Humanitarian Affairs (UNOCHA), employing a combined total of 13 staff members at a cost of approximately US\$270,000 per annum, had established administrative offices in Amman, Jordan. These arrangements resulted in duplication of tasks and unnecessary costs to the programme.

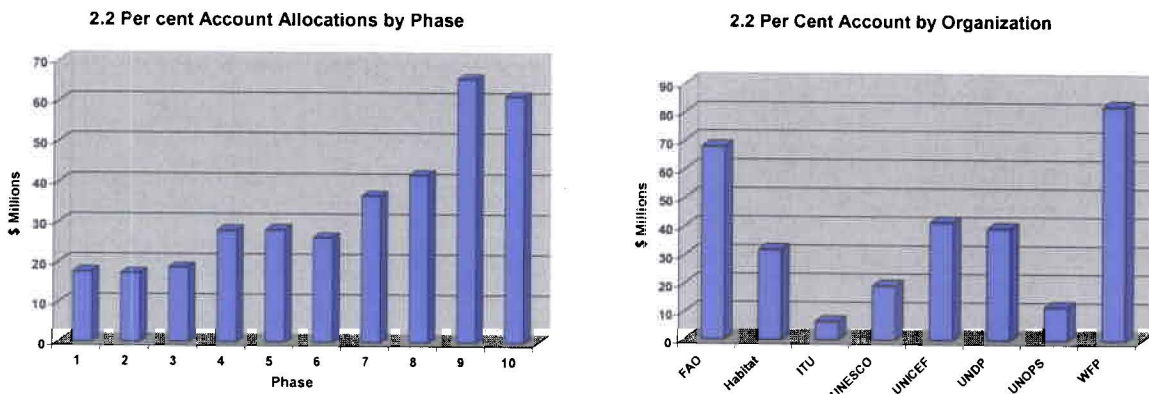
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I. INTRODUCTION

1. From December 2001 to January 2002, OIOS conducted an audit of the budget practices and procedures for UN agencies implementing programmes in Iraq under SCR 986 (1995) 2.2 per cent account. The audit was conducted in accordance with the general and specific standards for the professional practice of internal auditing in United Nations organizations.
2. The Office of the Iraq Programme (OIP) and Controller's Office is responsible for the preparation, review, approval and monitoring of the budget for the nine UN agencies operating under the Oil-for-Food Programme, in Iraq, as mandated by Security Council Resolution 986 (1995) and subsequent resolutions, and the Memorandum of Understanding (MOU) signed in 1996 between the Secretariat of the United Nations and the Government of Iraq.
3. Under the MOU with OIP the following UN specialized agencies implement projects in Northern Iraq: Food and Agriculture Organization (FAO), United Nations Development Programme (UNDP), United Nations Educational, Scientific and Cultural Organization (UNESCO), United Nations Children's Fund (UNICEF), United Nations Centre for Human Settlements, Habitat (UNCHS), United Nations Office for Project Services (UNOPS), World Food Programme (WFP), World Health Organization (WHO) and International Telecommunications Union (ITU). The MOU sets out the responsibilities in the areas of: (i) project services to be provided; (ii) property management; (iii) funding arrangements; (iv) financial reporting and accounting; and (iv) other administrative matters.
4. Under the Oil-for-Food programme, 2.2 per cent of revenues from oil sales are allocated for operational and administrative support cost for OIP headquarters, institutional contracts, UN Office of the Humanitarian Coordinator for Iraq (UNOHCI) and the nine UN agencies and programmes operating in Iraq. In addition, the 2.2 per cent account also funds UN Headquarters activities related to staff cost, travel, supplies, furniture and equipment. Up to Phase 10 of the programme, allocations to the 2.2 per cent account totalled \$885.1 Million. Figure 1, shows the 2.2 per cent account allocations by phase and by UN agency. Each of the UN agencies operating in Iraq under the Oil-for-Food programme submit budgets to the UN for approval.

Figure 1



5. Management's comments on the draft audit report are reflected as appropriate and are identified in italics.

II. AUDIT OBJECTIVE

6. The audit objectives were to: (i) assess the adequacy of the procedures to prepare, review and approve the 2.2 per cent budget; (ii) evaluate the appropriateness of the budget submissions by the UN agencies; and (iii) determine if appropriate procedures had been established to monitor the implementation of the budget.

III. AUDIT SCOPE

7. Based on the identified risks, the audit covered the policies and procedures governing the budget process. The methodology included a review of relevant documentation including budget proposal of UN agencies, and a review of comments on budgets by UNOHCI and the Controller. In addition, interviews were conducted with OIP, the Controller's Office and UNOHCI officials involved in the budget process.

IV. FINDINGS AND RECOMMENDATIONS

A. Budget System and Procedures

Appropriate policies and procedures need to be established

8. Three separate offices, UNOHCI, OIP and the Controller's Office are involved in the review of budgets submitted by the UN agencies and programmes implementing SCR 986-funded projects in Iraq. An essential element to provide adequate coordination among these offices is to establish written procedures and guidelines.

9. Instructions issued by OIP to the UN agencies provide for a 74-day process. After review by OIP, the budget is consolidated by them and submitted to the Controller for further review and final approval. OIP has taken certain measures to improve the budget review by involving UNOHCI and by extending the budget cycle from a six-month to a twelve-month cycle effective January 2002. However, we found that:

- The role of OIP, UNOHCI and Controllers' Office in the review process had not been clearly defined or documented.
- UNOHCI, which is involved at the initial stages of the budget process, did not have adequate organizational arrangements in place. Both UNOHCI in Baghdad and in Northern Iraq were involved in the process. An ad-hoc committee, which included the UNOHCI CAO and the Humanitarian Coordinator, has been established to review budgets. In our opinion the budget review process would be more effective if a permanent budget review committee was established in Iraq with representatives

from both Northern Iraq and Baghdad UNOHCI staff. Furthermore, their functions and roles need to be clearly defined and they should have full-time responsibility for UN agencies' budget matters.

- ⇒ There was no assurance that the budget changes proposed by UNOHCI were included in the UN agencies' budget sent to OIP. For example, FAO's submission in Phase 10, was made without due regard to UNOHCI's concern regarding FAO's capacity to implement its activities.
- ⇒ In Phase 10 of the programme, the Controller reduced agencies' budgets by approximately \$10 million or 14 per cent (Figure 2) putting into question the effectiveness of the review by OIP and UNOHCI.

Figure 2

**2.2% Account – Budget reductions made by Controller
July – December 2001 (Phase 10)**

Agency	Proposed by OIP (\$)	Approved by Controller (\$)	Reduction (\$)	Percentage Reduction	Reasons
FAO	16,477,015	11,880,825	4,596,190	27.9	70% related to staff cost
ITU	2,836,133	2,374,133	462,000	16.3	100% reduction in staff cost.
UNDP (DESA)	1,025,840	1,025,840	0	0.0	
UNDP (DEX)	6,673,036	6,042,666	630,370	9.4	
UNDP (GS)	464,440	464,440	0	0.0	
UNESCO	4,388,099	3,207,599	1,180,500	26.9	100% reduction in staff cost
UN Habitat	10,346,966	8,586,006	1,760,960	17.0	42% reduction in Office Equip. and 36% in staff costs.
UNICEF	8,069,141	7,934,241	134,900	1.7	
UNOPS - IDP Support	1,170,157	1,096,757	73,400	6.3	
UNOPS – JHIC	870,455	870,455	0	0.0	
UNOPS - (Mine Action)	2,542,399	2,542,399	0	0.0	
UNOPS – (WAT-SAN)	1,005,098	764,798	240,300	23.9	100% reduction in staff costs.
WFP	8,629,209	8,370,499	258,710	3.0	
WHO	8,230,597	7,586,827	643,770	7.8	
Total	\$72,728,585	\$62,747,485	\$9,981,100	13.7	

- ⇒ Deadlines for the submission of the budgets had not always been met. For example, a delay in FAO's budget submission for July to December 2001, delayed the submission of the budget for all UN agencies due to the practice of OIP submitting a

consolidated budget to the Controller. Consequently, the Controller issued letters of assurance to facilitate the renewal of staff contracts pending budget approval for staff costs.

- ⇒ We also found a number of errors in the budgets submitted by the UN agencies such as incorrect cross-referencing of tables and supporting details indicating that improved instructions and additional training may be required.

Recommendations 1 to 3

(i) OIP and the Controller should establish written policies and guidelines for the budget process, clearly defining the roles of UNOHCI, OIP and the Controller's office in the preparation, review and monitoring of budget submissions by UN agencies, in order to prevent duplication of effort and allow for a more transparent and effective budget process (AF2001/35/1/001);

(ii) OIP should provide additional training to UN agencies to provide a better understanding of the budget process and the requirements of OIP and the Controller in order to reduce level of errors in budget submissions (AF2001/35/1/002); and

(iii) UNOHCI should establish a permanent budget review committee for the 2.2 per cent account and establish a section with adequate staffing charged with responsibility for budget matters. (AF2001/35/1/003).

10. Response to Recommendation 001: In response to the draft report, OIP advised that " *the roles are clear to each of the three parties. OIP submits a consolidated budget to OPPBA for review*". The Controller's response indicated that "*OIP is the responsible Programme Manager and as such submits a consolidated budget to me for my review and approval*". Notwithstanding this explanation, and in light of the fact that OIP had introduced an additional layer in the budget review process and the absence of written documentation of policies and procedures to guide the review process, OIOS reiterates recommendation 001 and requests that OIP provide a timeframe to establish these policies.

11. Response to Recommendation 002: OIP and OPPBA agreed with this recommendation. In order to close this recommendation, please provide OIOS with the specific date and outline of the workshop.

12. Response to Recommendation 003: OIP did not agree with this recommendation and stated, "*UNOHCI has a budget section, which comprises two staff members. This is considered adequate for the purpose. Also budgets are reviewed by the Budget Officer, the Chief Administrative Officer (CAO) and the Humanitarian Coordinator. Given the occasional nature of budget submissions and the need for the submissions to be reviewed at a senior level within UNOHCI, this arrangement,*

albeit ad hoc, is considered to be superior to a standing committee comprised of less senior staff. OIOS believes that given the increasing and critical involvement of UNOHCI in the budget process, OIP should document and formalize the arrangement for the review of the budget in order to impart a more disciplined approach. We therefore reiterate this recommendation and request OIP to reconsider it.

B. Budget monitoring and reporting

Budget monitoring and control needs to be intensified

13. The budget process should be carried out in accordance with applicable United Nations financial regulations and rules, the MOU between OIP and the UN agencies, and instructions issued by OIP. The MOU stipulates that:

- OIP shall provide funding to agencies to cover expenditure in the 13 and 2.2 per cent accounts, and that such funds should be kept in separate accounts based on expenditure;
- OIP shall provide funding to agencies to cover programme support costs (PSC) which shall be paid from the 13 and 2.2 per cent accounts at the rate expressed as a percentage of actual disbursements;
- The UN agencies shall furnish audited financial statements;
- The UN agencies shall establish a special account, as well as an interest bearing special account for the receipt and accounting for funding provided under the MOU, to be administered in accordance with the agencies' financial rules and regulations; and
- Furnish certified standard monthly reports for expenditure incurred under the MOU.

14. The audit found that these areas were only partially being complied with by the UN agencies hence; there is a need for OIP to review their procedures in this regard and determine areas where additional compliance is needed. In our review of the financial statements, interest and monthly expenditure reports we noted several areas where additional steps should be taken by OIP as follows:

- Notwithstanding the requirements of the MOU and reminders sent to the agencies by the Accounts Division, some agencies (e.g. FAO, UNDP and UNESCO) failed to submit audited financial statements.
- The financial statement format often did not highlight relevant financial information regarding Iraq programme activities thus, limiting their usefulness as a monitoring tool. OIP also did not ascertain whether the accounts for the 2.2 and 13 per cent funds are kept separately as required by the MOU.

- Up until June 2001, interest payments made by agencies totaled \$573,818 ranging from \$4,270 by ITU to \$270,280 by WHO. However, the audit team could not verify the amounts reported by the UN agencies since there was no supporting documentation. The basis for the calculation used by the different agencies, were not clear and neither OIP nor the Accounts Division performed any reasonableness check on it. Furthermore, the submission of interest reports was frequently untimely.
- The standard financial reporting format required by OIP is not being used by all UN agencies and some reports are uncertified. In the review sample of reports for 2001, FAO, WHO, UNDP and ITU did not submit standard reports while UNICEF, UNCHS, UNOPS, UNDP and WHO did not certify financial reports.
- OIP does not ascertain the authenticity of certification of monthly financial reports and did not obtain a list of specimen signatures of the certifying officers approval to sign the reports.
- Inadequate provision is made in UN agencies budgets for internal auditing. OIP places heavy reliance on the submitted financial reports as an internal control and monitoring tool. In our view, it would be appropriate for OIP and the Controller to encourage the UN agencies to make a more realistic assessment of audit requirements and the need for resident auditors in Iraq.
- There was a general lack of back-up finance posts in OIP, which had led to inadequate monitoring, and control of UN agencies budgets. We were pleased to note however that OIP had initiated the recruitment of additional finance personnel.
- While the budget submission is based on standard expenditure categories and reviewed and approved by the Controller based on this, we found that redeployment between objects of expenditure codes did not require approval by the Controller. In addition, no analysis of actual and budgeted expenditure is done except at the time of the next budget exercise.

Recommendations 4 to 8

- (i) OIP should establish procedures for regular monthly monitoring of UN agencies financial statements, which should include an assessment of expenditure patterns and an analysis and investigation of unusual or large variances for possible remedial action (AF2001/35/1/004);
- (ii) OIP should request UN agencies to provide details on the calculation basis for interest payments and review their calculations to ensure that interest remitted is accurate. (AF2001/35/1/005);

(iii) OIP should obtain a list of certifying officers and specimen signatures from the UN agencies to enable them to verify that monthly financial statements are properly authorized (AF2001/35/1/006);

(iv) In view of the heavy reliance placed by OIP on internal audit coverage by the UN agencies to ensure that funds are used in an appropriate manner, OIP and the Controller should ensure that adequate resources are made available to the UN agencies to provide resident audit services in Iraq and of headquarters' activities financed from the Iraq programme (AF2001/35/1/007); and

(v) The Controller should establish a procedure to approve redeployment of budgeted funds between object of expenditure codes to ensure that funds are used for appropriate purposes in line with the original approval (AF2001/35/1/008).

15. Response to Recommendation 004. OIP accepted this recommendation, however, in order to close it we request that OIP provide us with a copy of the procedures to conduct regular monitoring of agencies' financial statements.

16. Response to recommendation 005: This recommendation was accepted. In order to close this recommendation, we request OIP to provide us with the instructions sent to the UN agencies.

17. Response to Recommendation 006: OIP noted this recommendation, stating: "*It should also be noted that there is no evidence that the financial statements being submitted by the agencies are not properly authorized.*" OIOS reiterates this recommendation given the significance of the certifying function, and requests that OIP reconsider its position.

18. Response to recommendation 007: OIP accepted this recommendation and "*supports the provision of adequate internal audit resources of all agencies. However, it is not for OIP to determine what is an adequate level of resources. That is best done by the individual agencies working, it is suggested, in cooperation with OIOS*". The Controller indicated "*I have approved all resident internal audit resources that were requested to date.*" This recommendation has been closed.

19. Response to recommendation 008: The Controller advised that "*this issue will be looked at as part of the budget review process during the period July to December.*" In order to close this recommendation, we request that the Controller inform OIOS of the steps taken to implement it.

There is need for more effective analysis of UN agencies expenditure

20. Overall, OIP and the Controller have been successful in containing administrative costs for the UN agencies. However, there were certain areas where it was felt that an analysis of expenditure patterns would yield cost savings. For example, six UN agencies had established offices in Amman

(Figure 3). Only the UNDP office provided services to meet programme objectives. The other UN agencies including UNOHCI, which employ a combined staff of 13 at a cost of approximately \$270,000 per year, were used for liaison and administrative purposes (see Figure 3). In our view, this was an inefficient and costly arrangement and it would be appropriate for OIP and UNOHCI to review it.

Figure 3

UN Agency Offices in Amman					
UN Agency	Professional	GS	Total Staff	Total Annual Salary Cost (\$)	Functions
WHO		3	3	35,280	Administrative
UNESCO	1	3	4	140,800	Administrative/procurement
Habitat		2	2	21,600	Administrative
UNDP	6	0	6	1,155,600	Procurement
UNICEF		4	4	72,000	Administrative/logistics
UNOHCI		2	2		Administrative
	7	14	21	1,425,280	
Total cost excluding UNDP				\$269,680	

21. We also noted certain inconsistencies in the staffing level of the UN agencies for their offices outside Iraq. For example, in Phase 10 (Figure 4), WHO had 26 staff outside Iraq at a cost of approximately \$900,000 while WFP did not have any staff outside Iraq. Even large programmes such as Habitat had significantly fewer staff members outside Iraq. There was no indication that OIP had analysed the situation to determine why such staffing levels were needed. In our view, OIP and the Controller should review this situation and reassess staffing requirements for the UN agencies in order to prevent unnecessary expenditures.

Figure 4

COSTS OF STAFF OUTSIDE IRAQ									
Agency	D-2	D-1	P-5	P-4	P-3	P-2	GS/ others	Total staff	Salaries (6 months)
FAO				1	1	2	17	21	\$761,500
Habitat			1		4	2	19	26	\$473,400
ITU			1				2	3	\$164,000
UNESCO			1	4	3	2	9	19	\$585,100
UNDP-DE	1						9	10	\$835,800
UNICEF				3	2		21	26	\$846,900
WFP								0	\$0
UNOPS			1				1	2	\$134,031
WHO		1	1	5			19	26	\$908,191
	1	1	5	13	10	6	97	133	\$4,708,922

Notes:

P level includes equivalent L level staff.

Others include staff members classified as NOA, NPO, SSA, FT, etc.

UNOPS figures are for mining operation only.

Recommendations 9 to 10

- (i) OIP should review the possibility of establishing a joint office in Amman to provide liaison administrative services for UN agencies operating under SCR 986-funded programmes in Iraq to allow for greater efficiency and reduce costs to the programme (AF2001/35/1/009); and
- (ii) OIP and the Controller should establish policy guidelines for UN agencies' employment of personnel outside Iraq that should include staffing levels, grades, locations, ceilings on staff, etc. to minimize costs to the programme (AF2001/35/1/010).

22. Response to Recommendation 009: OIP did not provide a specific response to this recommendation. We request OIP to indicate whether this recommendation is accepted, and if accepted to provide an implementation timeframe.

23. Response to recommendation 010: In reply to this recommendation OIP stated that *"the revised budget procedures for the 2003 budget can be expected to include more specific requirements for agencies to justify their staffing levels."* The Controller indicated *"this issue will be looked at as part of the budget process during the period July to September."* When the issue has been reviewed, please provide OIOS with the details of the action taken to implement this recommendation.

V. ACKNOWLEDGEMENT

24. We wish to express our appreciation for the assistance and cooperation extended to the auditors by the UNOHCI, OIP, and OPPBA.